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No. 20

In the Supreme Court of the United States

OCTOBER TERM, 1955

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The pertinent opinions of the Tax Court are (1) an opinion relating to the taxable year 1940 (R. 22–30), reported at 16 T. C. 395, and (2) an unreported memorandum opinion (R. 201–215) relating to the taxable year 1942. The opinion of the Court of Appeals (R. 293–299) is reported at 215 F. 2d 513.[1]

[1] The opinion of the court below, as well as the memorandum opinion of the Tax Court in the 1942 case, also related to issues other than those presently before this Court. In addition, in the 1942 case the Tax Court rendered a supplemental opinion (R. 216–219), reported at 20 T. C. 503, with respect to a matter not here pertinent.

JURISDICTION

The judgments of the Court of Appeals were entered on August 25, 1954 (R. 300, 301). A petition for rehearing (R. 302–310) was denied on September 27, 1954 (R. 310–311). The petition for a writ of certiorari was filed on November 22, 1954, and was granted on January 10, 1955, with respect only to questions 1 and 2 presented in the petition for certiorari (R. 311–312; 348 U. S. 911). The jurisdiction of this Court rests on 28 U. S. C., Sec. 1254.

QUESTIONS PRESENTED

The order granting certiorari (R. 311–312) limits review to questions 1 and 2 presented in the petition for certiorari which read as follows:

1. "Are transactions in commodity futures which are not 'true hedges' capital asset transactions and thus subject to the limitations of Section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions? (1940) (1942)"

2. "Are commodity futures contracts 'securities' and thus subject to the 'wash sales' provisions of Section 118 of the Internal Revenue Code of 1939? (1940) (1942)".

STATUTE INVOLVED

The relevant portions of Sections 112, 117, 118, 710, 711, 712, 713, 728, and 729 of the Internal

Revenue Code of 1939[2] are set forth in the Appendix, *infra*, pp. 59–67.

STATEMENT

In so far as material to the two questions before this Court, the facts, as found by the Tax Court in the two cases before it (R. 22–25, 202–206) and as stated by the court below (R. 293–295), are as follows:[3]

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[2] Unless otherwise indicated, references to the Code will be to the Internal Revenue Code of 1939.

[3] In the 1940 case, the Tax Court decided only the second question, against the taxpayer—it being unnecessary for it to pass upon the first question, because the taxpayer could not, as a matter of computation, prevail in that case unless both questions were resolved in its favor (R. 26–29). In the 1942 case, the Tax Court did decide both questions, against the taxpayer, and it also passed upon several other matters not here material (R. 211–215, 216–219).

The Tax Court's findings of fact in the first case (R. 22–25) were based upon a stipulation of facts (R. 31–34) and accompanying exhibits (R. 35–39), and certain testimony (R. 49–94) and additional exhibits (R. 95–152) adduced at the hearing. Subsequently, in the second case, the parties submitted a new stipulation of facts and exhibits (R. 220–228, 230–236), which, insofar as material here, supplemented the information previously submitted and provided (R. 226) that the record in the first case be considered as evidence in the second case. The testimony in the second case (R. 248–263) did not relate to the two questions presently here.

Our recital of the facts here generally follows the findings in the second case (R. 202–206), with occasional reference to the findings in the first case and other parts of the record, as indicated. There was no significant change in the taxpayer's method of doing business between the years 1940 and 1942 (R. 206).

The taxpayer, a New Jersey corporation with its principal office in New York City, is engaged in the manufacture and sale of corn products, including starches, sugar, oils, and feeds. The principal product obtained by the taxpayer from raw corn is starch. Cerelose, one of its major products, is a refined sugar derived from starch which competes with cane and beet sugar. Its plants have a daily grind capacity of 170,000 bushels and a raw corn storage capacity of some 2,300,000 bushels, somewhat less than a three weeks' supply.[4] Between the years 1938 and 1942, its purchases of raw corn ranged from some 35,000,000 to some 60,000,000 bushels annually.[5] (R. 202–203.)

The taxpayer's sales policy has been in general, with certain exceptions, to contract for shipment within 30 days at specified prices, but giving the customer the benefit of market price at the time of delivery if lower. Also, it has been the taxpayer's practice to cancel any unfilled portion of an order at a customer's request. (R. 203.)

Among the exceptions or variations in the taxpayer's general sales policy were contracts with three other companies, respectively requiring the taxpayer to furnish, for periods ranging from 10

[4] Similar conditions existed in 1940 and in prior years (R. 23)—except that the daily grind capacity was 147,700 bushels in 1940 (R. 23, 33).

[5] The monthly and annual totals for those purchases are set forth in Exhibit 2–B to the stipulation of facts in the 1942 case (R. 231).

to 15 years, large quantities of starch or feed, either at a guaranteed price, or upon a price formula dependent on a number of factors including the price of corn and labor. Also, in January 1940, the taxpayer invited all buyers to submit orders for Cerelose for delivery as late as in the month of June, at the lower of the January 15 price or market on date of delivery, with cancellations permitted, and on that occasion the taxpayer sold about 2,000,000 bags of Cerelose. Also, members of the canning industry on the Pacific Coast have been permitted to call on the taxpayer for Cerelose for delivery in more than 30 days, with price guarantees and allowance for cancellations. (R. 203–204.)

For a number of years, it was the taxpayer's practice to purchase and sell corn futures contracts through members of a commodity exchange. A corn future is a contract calling for the delivery at a stated time, within 11 months or less, of 5,000 bushels of corn or some multiple thereof, of a stated quality, at a stated price. (R. 204.) The party contracting to furnish the corn has the option of delivering the corn on any day during the month in which the contract matures, or of furnishing a different grade, with an appropriate price adjustment. The buyer furnishes his broker with "margin", or a percentage of the contract price, until delivery is taken or the contract is sold, at which time final settlement is made. The

contracts are freely dealt in on the commodity exchange. (R. 23.)

The taxpayer engaged in futures transactions "as a part of its corn buying program," and "as the most economical method of obtaining an adequate supply of raw corn" in view of its limited storage facilities and the expense of increasing them sufficiently to meet its needs.[6] It bought futures when the price was advantageously low, beginning its buying each year at harvest time, and usually selling most of its futures in the early summer if it then appeared that there would be no corn shortage and no great danger of higher prices—while, if the latter occurred, it gradually sold its futures as it bought for grinding. The taxpayer took delivery on some contracts.[6] (R. 204.)

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[6] As shown by monthly figures in Exhibit 4-D in the 1942 case, the futures contracts purchased by the taxpayer during the years 1938 through 1942 on which it took delivery aggregated 4,975,000, 2,865,000, 250,000, 2,175,000, and 4,460,000 bushels, respectively. (R. 234–235.)

During the same years, the taxpayer bought futures contracts which were later sold aggregating 19,675,000, 14,470,000, 8,125,000, 4,115,000, and 8,675,000 bushels, respectively, as appears in Exhibit 3-C to the 1942 stipulation. (R. 232–233.)

The futures contracts sold by the taxpayer during each of these years amounted to 17,400,000, 14,180,000, 14,595,000, 2,545,000, and 5,695,000 bushels, respectively. (Ex. 5-E, R. 236.)

A detailed weekly analysis of stock on hand and unfilled orders, as to Cerelose and feed, respectively, during the period 1938 through 1942, appears in Joint Exhibit 6-F (R. 95–99, 265–269) and Joint Exhibit 7-G (R. 100–101, 270–271).

The futures contracts were not subject to depreciation and were not included in inventory—the taxpayer's raw corn inventory being affected only when delivery was taken under a futures contract. Profits or losses on futures were shown in a "Corn Miscellaneous" account, the net gain or loss for each year being debited or credited to cost of sales and treated as a reduction of or addition to cost of goods sold. (R. 204.)

High corn costs following droughts in 1934 and 1936 had resulted in losses on Cerelose sales by the taxpayer in 1937 and, to avoid or minimize similar losses, the taxpayer increased its buying of futures so as to have corn available at prices permitting competitive selling of Cerelose with beet and cane sugars—but it never reached its goal of a "long" position of 12,000,000 bushels in futures. (R. 23–24.) The outbreak of World War II in 1939 raised the price of cane and beet sugars to such an extent that the taxpayer no longer needed futures to assist it in successful competitive selling of Cerelose. At the beginning of 1940, it owned futures for over 8,000,000 bushels, but beginning about June, there being no indications of a shortage in crops in that year (R. 52), that "long" position was reduced, so that by the end of the year the taxpayer had only about 1,400,000 bushels in futures. (R. 24.)

In late 1939 and early 1940 the taxpayer had maintained a "long" position in futures of some seven to eight million bushels. In 1940, the Com-

modity Exchange Authority formally charged the taxpayer with speculating in grain, upon the ground that it had a "long" position exceeding by more than two million bushels the amount required for hedging. At a hearing, the taxpayer contended that its futures were not in excess of its needs and that its futures holdings were necessary to cover the products it expected to market over a period of 15 to 18 months. In demonstrating its needs, the taxpayer submitted evidence as to its unfilled orders, its sales commitments, including its long term contracts, and the estimated number of bushels required to meet such commitments. The taxpayer also relied upon the weekly and daily reports it had filed with the Authority giving information as to its position with respect to grain futures. In those reports, the taxpayer had included, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain or grain products, and had stated that its futures were classifiable in character as hedging, rather than as speculative transactions. The taxpayer was upheld in its contentions in the proceedings before the Authority, and the action was dismissed.[7] (R. 204–205.)

[7] As the taxpayer points out (Br. 18–19, 29, 42), there has since been a similar proceeding against it, decided in December 1954. *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117. There, the taxpayer was charged with excessive trading and holdings in corn futures in 1952. The proceeding is now pending, on appeal by the taxpayer, before the Second

From its purchases and sales of corn futures, the taxpayer had a net profit of $680,587.39 in 1940 (R. 24), and a net loss of $109,969.38 in 1942 (R. 206).[8]

During 1942, the taxpayer had gross sales of more than $131,000,000 and gross profits therefrom of more than $35,000,000.[9] Its opening and closing inventories for 1942 (inclusive of raw corn and processed products, valued at the lower of cost or market) were approximately $7,650,000 and $5,900,000, respectively.[10] (R. 206.)

The taxpayer's purchases of corn futures did not constitute speculative transactions for profit, but were consummated in order to obtain business protection and to insure the profitable conduct of its business (R. 206).

Circuit, *sub nom. Corn Products Refining Co.* v. *Benson, Secretary of Agriculture.*

[8] The profit or loss figures from futures for all years 1932 through 1942 were stipulated (R. 221). For the years 1936 through 1939 (its "base period" years—i. e., the years upon the basis of the income for which its excess profits taxes for the taxable year 1940 and 1942 are determined), the taxpayer had a net loss of $165,532.27 for 1936; a net gain of $590,339.35 for 1937; and net losses of $815,462.57 and $424,437.54 for 1938 and 1939, respectively.

[9] The corresponding figures for 1940 gross sales and gross profit therefrom were $55,000,000 and $18,000,000, respectively (R. 117).

[10] The corresponding figures for opening and closing inventories for 1940—similarly including raw corn and processed products (R. 81)—were some $4,988,000 and $4,800,000, respectively (R. 123).

The parties stipulated, for each of the taxable years (1940 and 1942), the separate gain or loss to the taxpayer from the sale of futures held for not more than 6 months and of those held more than 6 months, as computed both with and without the application of Section 118 of the Code [11] (R. 205–206).

Upon the basis of the foregoing findings, the Tax Court on these two issues held, contrary to the taxpayer's contentions, (1) that the taxpayer's gains and losses from its futures transactions are to be treated as resulting in increases or decreases in ordinary income, and not as capital gains and losses within Section 117 (R. 211–212); and (2) that the taxpayer's futures transactions are not within the wash sales provisions

[11] The stipulation shows that the taxpayer, by the application of Section 118, for 1940 would arrive at capital gains of $62,328.10 and capital losses of $202,662.60, instead of the net profit of $680,587.39 (R. 32–33; see also R. 27). Similarly, for 1939, the last year of its "base period," the taxpayer by the use of Section 118 would arrive at losses aggregating $244,550.03, instead of the net loss of $424,437.54; and for 1942 the taxpayer would arrive at capital gains totaling $75,769.38, instead of a net loss of $109,969.38 (R. 222–224). The table (Ex. 1–A, R. 230) submitted with the stipulation contains a detailed analysis of the effect, on taxpayer's theory, of the application of Section 118 to futures tradings for all of the years 1936 through 1942, showing specifically (under column "15") the total amount of the claimed "Wash Losses," in net result, for each of the years as follows (in round figures): for 1936, $227,000; for 1937, $3,300; for 1938, $1,177,000; for 1939, $1,978,000; for 1940, $520,000; for 1941, $45,000; and for 1942, $261,000.

of Section 118 (R. 26, 27–30, 212). The Court of Appeals unanimously affirmed (R. 293–298).

SUMMARY OF ARGUMENT

I

This case involves two questions, the second of which will be reached only if this Court reverses the court below, and holds, contrary to our contentions on the first question, that the gains and losses from taxpayer's futures transactions qualify for capital asset treatment under the Internal Revenue Code.

A. In general, under the Code the annual profits derived from the ordinary carrying on of a trade or business are taxed as ordinary income. Preferential treatment is, however, accorded by Section 117 to the results of dealings in property called capital assets, that are not the normal, direct source of business profits. The definition of a capital asset in Section 117 embodies an unusual draftsman's technique—the definition is specific only in stating what is *not* a capital asset. Taxpayer argues that because futures contracts do not fall strictly within the exclusions from Section 117 they must be held to be capital assets notwithstanding that they were employed, as held by both lower courts, as an integral part of the day-to-day operations of taxpayer's manufacturing business.

Taxpayer's approach ignores the settled rule that the scope of the preferential capital gains

provisions of the Code is to be strictly construed. Thus in *Burnet* v. *Harmel*, 287 U. S. 103, 106, one of the first cases to reach this Court following the inclusion of capital gains provisions in the income tax law, the Court indicated that the new provisions were to be strictly construed to effect the congressional purpose of relieving the taxpayer from the "excessive tax burdens on gains resulting from a conversion of capital investments" which it noted would often have accrued "over long periods of time." A necessary corollary of the rule that the capital asset definition of Section 117 is to be narrowly applied is that the exclusions from the capital asset definition shall be broadly applied so as not to frustrate the congressional purpose of limiting the preferential treatment to property in the nature of investments, not employed as an integral part of the day-to-day income producing activity of the taxpayer. Numerous decisions of the lower courts illustrate the application of these rules to varying fact situations. In none of these cases did the courts permit the receipts in question to qualify for capital gains treatment where to do so "would have tended to defeat rather than further the purpose of the Act." *Burnet* v. *Harmel*, 287 U. S. 103, 108.

In harmony with this approach to the capital gains provisions, it has long been the administrative and judicial construction of the statute

to regard hedging transactions as resulting in ordinary business profits or expenses, and not in capital gains or losses. Since hedging transactions are generally regarded as a form of insurance, it was a sensible view of the statute—subsequently recognized and concurred in by Congress—to treat the costs of hedging activities as a normal operating expense or as an inventory cost, and to treat the profits from such activities as normal operating profits.

Both of the lower courts concluded, on the basis of the record facts, that the taxpayer used futures transactions as an integral part of its manufacturing business and they both concluded, quite properly, that the results of those transactions, like the results of true hedging operations, must be reflected as ordinary income and deductions—not as capital gains or losses.

B. The taxpayer's transactions in corn futures served a twin business purpose in its manufacture of corn products. It used its futures transactions as a guaranty of a source of supply, thus compensating for its own limited storage capacity and limited inventory of raw corn. It also used futures to protect its manufacturing profit and the competitive position of its products against increases in the price of corn. While the taxpayer did not have protection against price declines as well, as it could have had if it had sold its products at fixed prices, that is unimportant to the tax

result. The important thing is that it did use futures to shift the risk of increases in price, and that was the contingency which it feared more than price declines.

The fact that taxpayer had partial rather than complete protection against price changes in raw corn has even less significance in view of the fact that it also used its futures transactions to guarantee it a supply of corn. Under these circumstances, the courts below were correct in holding that the costs of taxpayer's futures transactions were an operating expense of its business and were not capital losses, and that, to the extent that the futures transactions resulted in profits, they were operating profits of the business rather than capital gains.

The taxpayer makes several factual contentions in an effort to dispute the conclusions of the lower courts that its futures transactions formed an integral part of its business operations and it asserts, rather, that it dealt in corn futures as an independent "capitalist". But these contentions are contradicted by the record facts, including the testimony of the taxpayer's own witnesses, and by the permissible factual conclusions drawn by both lower courts. In this respect the decision below constitutes little more than the resolution of a factual issue adversely to taxpayer. Taxpayer's assertions in its brief that it bought and sold futures as an independent "capitalist" separate and apart from its manufacturing business, and

its claim to be taxed on that basis, finds no support in the record.

II

If this Court agrees with the lower courts on point I, namely, that taxpayer's futures transactions resulted in ordinary income and ordinary deductions, rather than in capital gains and losses, there will be no need to consider the further issue raised by the taxpayer, namely, whether its losses from futures transactions are subject to the "wash" loss provisions of Code Section 118. If, however, it should be held that the taxpayer had capital gains and losses from these transactions, then we contend that the losses are not subject to the provisions of Section 118.

A. Section 118 prohibits the deduction of losses sustained from the sale of securities only when the taxpayer, within a limited time, acquires identical or "substantially identical" stock or securities. Contracts for the future delivery of commodities are not substantially identical, one with another, even if they could be regarded as securities. The significance of differences in maturity of different futures contracts is, of itself, so substantial as to require the conclusion, concurred in by both courts below, that the taxpayer was not engaging in "wash sales" (a practice unlawful under the Commodity Exchange Act) because it was not buying and selling "substantially identical" securities.

B. Section 118 is not applicable for a further, independent reason. That section is concerned with wash losses from sales of "shares of stock or securities." Contracts for the future delivery of commodities are neither "shares of stock" nor "securities." The purpose of the section was to prevent the deduction of fictitious losses, an evil not present in the case of dealings in commodity futures, which are contracts for short periods of time. The normal meaning of the term "securities", the congressional use of that term in other sections of the Code, and the fact that Congress has always referred to commodity futures specifically when it intended to describe such contracts, give force to the conclusion of the lower courts that commodity futures are not securities within the meaning of Section 118.

ARGUMENT

I

TAXPAYER'S CORN FUTURES TRANSACTIONS GAVE RISE TO ORDINARY INCOME AND ORDINARY DEDUCTIONS

A. THE INTERNAL REVENUE CODE TREATS AS ORDINARY INCOME TRANSACTIONS THE ANNUAL GAINS AND LOSSES FROM THE OPERATION OF A MANUFACTURING BUSINESS

This case involves the proper tax treatment, i. e., as ordinary gains and losses or as capital gains and losses, of certain transactions in commodity futures. Both courts below held that the taxpayer had engaged in these transactions as an integral part of its manufacturing business for

the twin purposes of obtaining protection against increases in prices of its basic raw material and of assuring itself a sufficient supply thereof to meet anticipated future requirements. Because these transactions were carried on to stabilize inventory costs and thus protect profit, both courts concluded that the results thereof were not entitled to capital gain or capital loss treatment under Section 117 of the Internal Revenue Code of 1939 (*infra*, pp. 59–60). In its returns for the years here involved (and for prior years), taxpayer accounted for the results of its futures transactions, as we think it should, as ordinary profits and losses (R. 24, 211, 222). It is our position that that treatment was correct,[12] and that accordingly the decision below should be affirmed.

The case presents a question as to the proper construction to be given to Code Section 117 which provides that gains from transactions in certain property, with important exceptions, should be taxed at preferential rates as capital gains, and which imposes restrictions on the deduction of losses therefrom as capital losses. In general, under the Internal Revenue Code, the annual profits derived from the carrying on of a trade or business are taxed as ordinary income. The tax treatment of business profits is the same as that given to the normal classes of in-

[12] The changed basis of accounting for the results of its futures transactions which taxpayer now seeks, if taxpayer prevails on both issues herein, will allegedly have tax consequences aggregating at least one and a half million dollars.

come in the economic world, *e. g.*, compensation for personal services, dividend income, rents, royalties, etc.; and losses suffered in the conduct of a business are treated as ordinary losses, fully deductible against income. Preferential treatment is, however, accorded by Section 117, to the results of dealings or transactions in property which are not the normal source of business income, and there are strict limitations on the deduction of losses from transactions in such property.

The definition of a capital asset in Section 117 embodies an unusual draftsman's technique—the definition is specific only in stating what is *not* a capital asset. The congressional purpose in granting special tax preference to gains from, and of limiting the deductions of losses on, the sale or exchange of capital assets must be gleaned from the exceptions enumerated in the statute, *i. e.*, from the kinds of gains or losses which do not qualify for special consideration.

That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.

The taxpayer's claim to capital asset treatment of its futures transactions rests on a simple syllogism: its futures contracts were "property"; they were not its stock in trade; they did not (strictly) form part of its inventory; they were not being held for sale to customers and they were not subject to depreciation. With these statements we agree. But we disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets. (Br. 13–15, 32–33, 36–37.)

This approach is fallacious in that it ignores the settled rule that the scope of the preferential capital gains provisions of the Code shall be strictly construed. Moreover, it ignores the role which commodity futures played in the day-to-day conduct of taxpayer's manufacturing business (see pp. 31–41, *infra*); in no real sense were these transactions in capital assets, and to treat them as such for tax purposes would do violence to the basic purpose and scope of Section 117.

In *Burnet* v. *Harmel*, 287 U. S. 103, one of the first cases to reach the Court following the inclusion of special capital gains provisions in the income tax law, this Court indicated that their scope was to be strictly construed. In that case the taxpayer contended that bonus payments received in consideration of the execution of oil

and gas leases represented proceeds from the sale of capital assets (*i. e.*, sale of the oil in place) and were entitled to capital gains treatment. In dealing with this contention, the Court first looked to the purpose of the Act (*id.* at 106):

> Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate * * * were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.

The Court then noted that "the taxation of the receipts of the lessor as income does not ordinarily produce the kind of hardship aimed at by the capital gains provision of the taxing act", and that, moreover, to regard the transaction as a sale within the meaning of Section 208 of the Revenue Act of 1924, c. 234, 43 Stat. 262, would ignore the fact that the extraction of minerals had long been regarded as resembling "a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident" (*id.* at 106, 107). The Court concluded

that the payments were not entitled to capital gains treatment; such a result "would have tended to defeat rather than further the purpose of the Act" (*id.* at 108).

This approach has two aspects, in view of the form of Section 117. On the one hand, as this Court indicated in *Burnet* v. *Harmel,* 287 U. S. 103, the usual rule that statutory exceptions from income tax under the provisions of the Internal Revenue Code are to be strictly construed, requires that the capital asset definition be narrowly applied. See *Ogle* v. *Helvering,* 77 F. 2d 338, 339 (C. A. 2d); *Sloane* v. *Commissioner,* 188 F. 2d 254 (C. A. 6th). As a necessary corollary, the exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Thus, this Court and the lower courts have consistently refused, in a wide variety of circumstances, to treat as capital gain, or as a return of a capital investment, receipts which are not the kind of gain for which the statute intended preferential treatment. In many situations capital gain or loss has been denied, even though, superficially, the transactions qualified under the literal language of the capital-gains provisions. See *e. g., Kieselbach* v. *Commissioner,* 317 U. S. 399 (portion of lump-sum condemnation award which represented compensation for delay in payment taxed as ordinary income); *Hort* v. *Commissioner,* 313 U. S. 28 (lump sum received for can-

cellation of lease regarded as a substitute for rent, taxable as ordinary income, rather than as proceeds from sale of lease); *Helvering* v. *Smith*, 90 F. 2d 590 (C. A. 2d), and *Doyle* v. *Commissioner*, 102 F. 2d 86 (C. A. 4th) (sale of right to receive legal fee for services rendered, taxed as ordinary income rather than as sale of capital asset); *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C. A. 6th) (sale of right to receive previously declared dividend held not taxable as sale of capital asset); *Fisher* v. *Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U. S. 1014 (sale of past-due interest taxable as ordinary income); *Shuster* v. *Helvering*, 121 F. 2d 643 (C. A. 2d) (payment received on cancellation of employment contract taxable as ordinary income).

Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition. *Commissioner* v. *Bagley & Sewall Co.*, 221 F. 2d 944, 947 (C. A. 2d) (loss on United States bonds purchased in order to meet contract requirement that they be posted as security for performance of the contract and sold when released in accordance with the contract, held deductible as ordinary loss). See also, *Commissioner* v. *Western Wine & Liquor Co.*, 18 T. C. 1090, appeal dismissed, 205 F. 2d 420 (C. A. 8th);

Clark v. *Commissioner*, 19 T. C. 48, appeal dismissed June 18, 1953 (C. A. 9th), and *Hogg* v. *Allen*, 105 F. Supp. 12 (M. D. Ga.), affirmed on this point, *sub nom. Edwards* v. *Hogg*, 214 F. 2d 640 (C. A. 5th) (taxpayers who were in business of buying and selling whiskey and who purchased shares of stock in distilling companies in order to have opportunity of purchasing, on favorable terms, whiskey which was in short supply did not suffer capital loss on later disposition of the shares of stock, the loss being held to constitute a part of the cost of acquiring the inventory of whiskey); *Helvering* v. *Community Bond & Mortgage Corp.*, 74 F. 2d 727 (C. A. 2d) (loss on stock of another corporation purchased in order to dissolve it, thus cancelling an unprofitable contract with such corporation, held deductible as a business expense).

The tax treatment of gains and losses from hedging transactions in commodity futures [13] provides a further illustration of the proper construction of Section 117. In general, hedging transactions are entered into by manufacturers "to insure themselves against loss by unfavorable changes in price at the time of actual delivery of what they have to sell or buy in their business." See *United*

[13] A commodity future has been defined as "an agreement to buy or sell, in accordance with law and the rules of an exchange, a definite quantity of a commodity at an agreed price at a future date, being entered into for the purpose of speculating on or hedging against price changes." Hoffman, *Future Trading* 118 (1932). (See R. 204.)

States v. *Coffee Exchange*, 263 U. S. 611, 619. See further, *Browne* v. *Thorn*, 260 U. S. 137, 139–140.

The rules of the Commodity Exchange of New York broadly define a hedge transaction as a purchase or sale of a futures contract "executed for the purpose of minimizing a price risk or facilitating a customary or normal conduct of business" (R. 93). See also *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1131. "True" hedging operations are those where the manufacturer or processor, by matching forward business commitments with futures transactions on the commodity market concerned, shifts the entire, or virtually the entire, risk of price fluctuations in the commodity in question to others. Hoffman, *Future Trading* 4, 142–144 (1932). Hedging thus is a form of insurance of normal operating profits against the risks consequent upon fluctuations in the market price of the product in which the business deals, or the materials used by that business in its manufacturing operations. See *United States* v. *Coffee Exchange*, 263 U. S. 611, 619; *Board of Trade* v. *Christie Grain and Stock Co.*, 198 U. S. 236, 249. See also, Hoffman, *supra*, pp. 4, 142, 381–383.

The question as to the appropriate tax treatment of gains and losses from hedging transactions first arose under the Revenue Act of 1934, c. 277, 48 Stat. 680. Prior thereto, capital assets were limited by definition to assets held more than

two years. Since under the rules of various commodity exchanges, futures contracts were required in all cases to be closed out in periods shorter than two years, futures contracts were excluded from consideration as capital assets.

The Revenue Act of 1934, Sec. 117 (b), eliminated the two-year limitation from the definition of capital assets. Thereafter the Treasury Department in 1936 issued G. C. M. 17322, XV-2 Cum. Bull. 151, which distinguished between commodity futures transactions which were speculative and those which were engaged in for hedging purposes. The former, it said, fell within the scope of the capital assets provisions of the 1934 Act. But in harmony with *Burnet* v. *Harmel*, 287 U. S. 103, and cases like those cited at pp. 21-23, *supra*, which had looked to the underlying purpose of the capital gains provision, the ruling provided that since "hedging transactions are essentially to be regarded as insurance rather than a dealing in capital assets," gains and losses therefrom should be treated as ordinary business gains and losses (XV-2 Cum. Bull. at 155). The G. C. M. explained (*id.* at 152):

> Such hedges, which eliminate speculative risks due to fluctuations in the market price of cotton and thereby tend to assure ordinary operating profits, are common trade practices and are generally regarded as a form of insurance (the only kind available as protection against such risks) necessary

> to conservative business operation. Where futures contracts are entered into only to insure against the above-mentioned risks inherent in the taxpayer's business, the hedging operations should be recognized as a legitimate form of business insurance. As such, the cost thereof (which includes losses sustained therein) is an ordinary and necessary expense deductible under section 23 (a) of the Revenue Act of 1934 and corresponding provisions of prior Revenue Acts. . .

The contrary view, as this Court had stated in *Burnet* v. *Harmel*, 287 U. S. 103, 108, "would have tended to defeat rather than further the purpose of the Act."

The ruling has since been applied administratively and judicially. *Grote* v. *Commissioner*, 41 B. T. A. 247; *Battelle* v. *Commissioner*, 47 B. T. A. 117; *Stewart Silk Corp.* v. *Commissioner*, 9 T. C. 174. See also *Commissioner* v. *Farmers & G. C. Oil Co.*, 120 F. 2d 772 (C. A. 5th), certiorari denied, 314 U. S. 683; *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35 (C. A. 6th), rehearing denied, 148 F. 2d 208; G. C. M. 18383, 1937–2 Cum. Bull. 244; I. T. 3137, 1937–2 Cum. Bull. 164; and G. C. M. 18658, 1937–2 Cum. Bull. 77. *Cf. Tennessee Egg Co.* v. *Commissioner*, 47 B. T. A. 558; *Commissioner* v. *Covington*, 120 F. 2d 768 (C. A. 5th), certiorari denied, 315 U. S. 822; *Estate of Makransky* v. *Commissioner*, 5 T. C. 397, affirmed *per curiam*, 154 F. 2d 59 (C. A. 3d). Cf. further, *Commis-*

sioner v. Banfield, 122 F. 2d 1017, 1019–1020 (C. A. 9th).

Recognizing that the construction of Section 117 for which it contends is opposed to the established rule applicable to hedging transactions, taxpayer now seeks to attack the validity of that rule, even as it applies to "true" hedging operations (see Br. 18). It is led to do this because futures contracts do not, in the strict sense of the words, represent stock in trade, inventory, property held for sale to customers, or depreciable property used in a trade or business, i. e., strictly speaking, as urged by taxpayer, they do not fall within the broad categories of property excluded from the definition of a capital asset. But in this attack, taxpayer must fail. As this Court has indicated, the capital gains provisions must be read in the light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read, it becomes evident that Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments. "The purpose is to protect 'investment property' as distinguished

from 'stock in trade,' or property bought and sold for a profit." *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, 266–267 (C. A. 9th). Accord: *Kenan* v. *Commissioner*, 114 F. 2d 217, 220 (C. A. 2d); *Commissioner* v. *Shapiro*, 125 F. 2d 532, 535–536 (C. A. 6th); *Rieger* v. *Commissioner*, 139 F. 2d 618, 621 (C. A. 6th); *Watson* v. *Commissioner*, 197 F. 2d 56, 58 (C. A. 9th), affirmed, 345 U. S. 544.

The propriety of excluding from capital gains treatment gains and losses from hedging transactions has never before been questioned over the period of almost twenty years during which G. C. M. 17322, *supra*, has been administratively applied.[14] On the contrary, the courts have uniformly accepted the proposition that hedging transactions did not come within the capital asset concept of the statute. See cases cited, pp. 26–27, *supra*. In the concrete circumstances of particular cases there have been controversies concerning the proper application of the rule, and a limited

[14] The propriety of taking into account, in the determination of taxable income, the results of "hedges" in commodity futures transactions, in effect treating them as items affecting inventory or as inventory adjustments, had previously been recognized and has been consistently adhered to in the administrative practice, in the case of dealers in grain, cotton, and other commodities, and millers. See A. R. M. 135, 5 Cum. Bull. 67 (1921) (distinguishing A. R. M. 100, 3 Cum. Bull. 66 (1920)); I. T. 1166, I–1 Cum. Bull. 52 (1922); S. R. 5084, IV–2 Cum. Bull. 120 (1925); S. M. 5693, V–2 Cum. Bull. 20 (1926); I. T. 3123, 1937–2 Cum. Bull. 114.

amount of litigation has resulted; but no court has ever questioned the conclusion that at least "true" hedging transactions are not to be accounted for as capital gains or losses.

Congress, moreover, has recognized that Section 117 does not apply to hedging transactions. Thus Section 1233 (a) of the 1954 Code provides that gain or loss from "the short sale of property, *other than a hedging transaction in commodity futures*" is to be treated as gain or loss from the sale of a capital asset to the extent "that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of the taxpayer." [Italics supplied.] The committee reports of both houses of Congress, in connection with the enactment of that provision (H. Rep. No. 1337, 83d Cong., 2d Sess., p. A278, and S. Rep. No. 1622, 83d Cong., 2d Sess., p. 437), state:

> Under existing law bona fide hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations. To continue this result hedging transactions in commodity futures have been specifically excepted from the operation of this subsection.

We thus have the adoption of an administrative construction in 1936, under the first statute which posed the problem (the Revenue Act of 1934), followed by repeated reenactments of the same capital assets provision in the Revenue Acts of 1936, c. 690, 49 Stat. 1648; 1938, c. 289, 52 Stat.

447, and in the 1939 Code. More recently, that administrative construction has received legislative recognition in the 1954 Code. This administrative construction, which has been followed by the Tax Court and other courts, must, upon settled rules, be regarded as having received legislative sanction. See *Burnet* v. *Harmel*, 287 U. S. 103, 108; *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114–115; *National Lead Co.* v. *United States*, 252 U. S. 140, 146–147; *Commissioner* v. *Wheeler*, 324 U. S. 542, 547, fn. 10. Cf. *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, 431–432. That construction should not be disturbed at this late date.

It is important to emphasize that, contrary to the taxpayer's argument (Br. 18), the tax treatment of hedges is not an "exception" to the statute to be invoked only where "true" hedges are involved. As we have shown and as the court below observed: "The tax treatment of hedges * * * is simply a recognition by the courts that property used in hedging transactions properly comes within the exclusions of the section [117 (a)]" (R. 296). This case, accordingly, does not turn upon the narrow, artificial question whether the taxpayer's futures transactions come within the precise terms of a hypothetical "hedging exception." It depends, rather, on whether the profits and losses resulting from taxpayer's hedging transactions should be held to fall within the area of operating profits derived from carry-

ing on a business, and thus outside the scope of the preferential capital-gains-or-loss provisions of the statute.

It is, therefore, essential to examine the nature of taxpayer's transactions in commodity futures in the context of the over-all operation of its manufacturing business.

B. TAXPAYER'S TRANSACTIONS IN CORN FUTURES, AS HELD BY THE TWO COURTS BELOW, FORMED AN INTEGRAL PART OF ITS MANUFACTURING BUSINESS

1. Taxpayer purchased corn futures to obtain business protection and to insure the profitable conduct of its business.

In its business taxpayer used large amounts of corn. Its grinding capacity was 170,000 bushels per day. The maximum amount of raw corn which it could store during the relevant periods was roughly 2,300,000 bushels, or only about three weeks' supply, so it decided to buy corn futures in order to insure a supply of and a stable price for the raw product. (R. 294.) Its holdings of corn futures over the period 1940–1942 never exceeded the equivalent of about three months' requirements, and over most of the period totaled far less than three months' requirements. (See chart 1, *infra*.) As the Tax Court found (R. 204, 206):

> Petitioner engaged in futures transactions as a part of its corn buying program and as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities

> and the expense of increasing those facilities sufficiently to take care of its needs. Purchases of futures were made when the price of corn was advantageously low. Petitioner took delivery of corn on some contracts, but it usually sold most of its futures in early summer if it then appeared that there would be no shortage of corn and no great danger of increased prices. If the crop was poor or there was danger of a price increase it sold its futures gradually as it bought corn for grinding. Petitioner would begin to acquire additional futures contracts at harvest time each year.
>
> * * * * * * *
>
> Petitioner's purchases of corn futures did not constitute speculative transactions for profit, but were consumated in order to obtain business protection and to insure the profitable conduct of its business.

Taxpayer does not directly attack these findings of fact, which were affirmed by the Court of Appeals (R. 294). Its argument turns rather on the contentions (a) that the futures transactions were not sufficiently related to its business operations so as to be accountable, like gains and losses on inventory, as ordinary profits and losses from the operation of the business, and (b) that its futures transactions should be regarded as though made by an independent "capitalist," separate and apart from its business operations (Br. 23–38). Each of these contentions does not survive analysis.

(a) Taxpayer's futures transactions formed an integral part of its manufacturing business. By purchasing contracts for future delivery of corn, taxpayer achieved two business objectives which were important to it as a large-scale manufacturer of corn products. It protected itself against future increases in the price of raw corn and thus protected its manufacturing profit and the competitive position of its products (R. 51, 52, 54, 206, 297), for its policy was to sell under contracts which provided that the price shall be contract or market, whichever is lower. It also, to the extent of its holdings, assured itself of a future supply of corn which would enable it to maintain the scheduled volume of its manufacturing operations. In view of its limited storage capacity, it was cheaper to purchase futures than corn, since storage charges would have to be paid (R. 50–51). These considerations form the foundation of our position that taxpayers' futures transactions were, as held by the courts below, entered into as an integral part of its manufacturing operations "as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities" (R. 204), and "to stabilize inventory costs and thus protect profit" (R. 297).[15]

[15] *Cf. In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1125: "[Taxpayer's] trading in futures is not done for the purpose of speculating in price differences, but in good faith for the purpose of offsetting risks and reducing costs of its business. It regards such trading as proper and legitimate hedging."

Taxpayer, of course, did not have the complete protection against changes in the market price of its principal raw material of the sort which is available to manufacturers whose operations yield to the protection afforded by what is known as a "true" hedge. Such complete protection is available, for example, to processors who contract to sell manufactured products for future delivery at fixed prices and at the same time purchase an equivalent quantity of the raw material concerned for delivery at the same future date; if the price of the raw material rises, a profit is made on the futures contract which offsets the increased cost of the raw material, and, conversely, if the price of the raw material falls, a loss is realized on the futures contract which is offset by the lower cost of the raw material. In either case, the manufacturing profit is assured.

Such complete protection was not available to taxpayer, however, because it chose for business reasons sufficient to itself to sell its products under contracts in which the price to the buyer was fixed at contract price or market price, whichever was lower. The customer thus was assured the benefit of any decline in the market price, and was protected by its contract against any increase in the market price. On the other hand, if the price of corn increased, taxpayer's entire manufacturing profit might be wiped out.

Further, as taxpayer made clear (R. 23–24, 51), a substantial increase in the price of corn could impair the competitive position of its products.

In these circumstances taxpayer attempted to obtain some protection for its business; it did this by shifting the risk of increased corn prices to speculators, through the instrumentality of the corn futures market. It could not, without changing its method of selling (guaranteeing against price decline), protect itself against a price decline of corn products. Thus, given its business methods and its competitive position, "It feared the possibility of a price rise more than that of a price decline" (Br. 30). Therefore, in its futures market dealings, taxpayer purchased a type of insurance to protect its manufacturing profit against its *principal* risk. It was only partial insurance, to be sure, but, given its method of doing business, that was the extent that insurance against price changes in corn was available to it.

There is of course no exact correspondence between taxpayer's purchases of futures and its orders on hand plus anticipated sales for delivery as of the maturity dates of its futures contracts. That is so because taxpayer's futures-buying program was a mixed operation. As the courts below found, it was as much a part of its corn-buying program as it was a device for protecting

itself against increases in the price of corn. Taxpayer purchased futures, in part, as the most economical method of obtaining an adequate supply of raw corn in view of its limited storage facilities (R. 204).[16] It entered the market when it deemed prices to be "advantageously low" (R. 204), and it reduced its holdings about June or July if there were no indications of a short crop of corn (R. 52; R. 24, 204). In other words it sold its futures after it was assured that there would be no sharp rise in the price of corn because of a poor harvest. Over the years, it took deliveries of a substantial amount of corn under its futures contracts as they matured.[17]

In additional instances, taxpayer undoubtedly sold futures about to mature at the same time as it bought spot corn. This might well have been to its advantage because it could control the grade of corn delivered on spot purchases and at the same time effect minor cost savings. See Hoffman, *Future Trading*, pp. 99–110, 266–267, 277–280, 306–313. See also R. 79.

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[16] Cf. Rich and Rippe, *Tax Aspects of Commodity Futures Transactions with a Business Purpose*, 2 Tax L. Rev. 541, 557, 559–560 (1947). The authors suggest that futures purchases which are resorted to by a manufacturer because of inadequate storage capacity should be treated for tax purposes as having the same effect as purchases of the commodity itself, even though they do not meet the technical definition of hedging.

[17] The annual totals of futures contracts under which the taxpayer took delivery are, in bushels: 1938, 4,975,000; 1939, 2,865,000; 1940, 250,000; 1941, 2,175,000; 1942, 4,460,000 (Ex. 4–D, R. 234–235).

The broad relationship between taxpayer's holdings of futures and its orders on hand is shown on our Chart 1 (*infra*, p. 68).[18] See also joint exhibit 7–G (R. 101, 271). It will be seen that there is a broad correspondence between futures owned and orders, particularly in 1940 and 1942, the years involved in this suit. Prior to 1940, it had embarked on a policy of maintaining a long position in corn considerably in excess of orders on hand to protect its manufacturing profits and the competitive position of its products, but the onset of war, with increases in price of competitive cane and beet sugar, together with the large 1939 crop, caused it in 1940 to liquidate this long position (R. 52, 54, 55). The "interference" (R. 52) which taxpayer had had from the Department of Agriculture under the Commodity Exchange Act (see pp. 44–45, *infra*) may also have had something to do with the reduction of its long position in 1940.

Further insight into the business problem which confronted taxpayer is gained by a study of Chart No. 2, which compares taxpayer's holdings in futures to the volume of commercial corn carry-overs in terminal storage. It will be seen that taxpayer reduced its holdings of futures in 1940 and that, in contrast to the previous year,

[18] Chart 1 is based on the figures used by taxpayer to construct its chart at page 9 of its brief. Taxpayer's chart is misleading. By pyramiding futures on top of stocks on top of storage capacity, taxpayer has made very difficult a comparison between futures owned and orders on hand, which is the relevant comparison.

there was in 1940 a large carry-over in terminal markets.

Much of the taxpayer's brief is devoted to a discussion as to why its transactions were not "true" hedges (see especially pp. 28–31). There is no dispute as to this. We agree that the transactions were not "true" hedges. But that is not the issue in this case. Taxpayer's discussion of the nature of its operations would be significant only if it showed that taxpayer's futures transactions were so divorced from its manufacturing operations as to qualify for capital-gains treatment under Section 117. We will analyze the five points made by taxpayer at pages 28–31 of its brief from this point of view.

(i) Taxpayer states that "At almost all times Petitioner had on hand sufficient corn and manufactured inventory (stocks) to meet all of its customers' orders," and that "the amount of orders which could at any time have been applied to offset futures was insignificant," and refers to its chart at page 9 of its brief (Br. 28, 7, 38). We question these statements. It can be seen from our chart 1 (*infra,* p. 68) that in eight of the twelve periods during the years 1940 to 1942 shown on the chart, taxpayer had orders on hand in excess of stocks and that in six of these periods taxpayer's orders were substantially in excess of its stocks on hand. But in any event this comparison has no controlling effect on our present

inquiry. The size of taxpayer's stocks would be contolling to the question whether *short* sales of futures are hedges (see p. 35, *supra*). But taxpayer made no such short sales. On the contrary, it acquired a long futures position, which is the appropriate hedge against forward sales of products.

(ii) Taxpayer states that the "time and amount of Petitioner's purchases of corn futures had no relationship to the time and amount of orders for the sale of its products," and again it refers to its chart (Br. 28–29). But when its chart is reconstructed so as to show the relevant comparisons (*infra*, p. 68), we think it shows quite plainly that there was a broad relationship between futures owned and orders, as taxpayer's witnesses testified. Thus its witness Hall, who at the times material was a vice president (R. 72), testified: "Whatever [futures] we had was what we needed for the scope of our business" (R. 73). Further, he testified (R. 76), with respect to 1940, that "we needed the corn we had." Similarly, testimony of record shows that in 1940, when taxpayer was involved in difficulties under the Commodity Exchange Act, it asserted that it was entitled to acquire futures contracts as a hedge against the products it "expected to market over a period of * * * fifteen or eighteen months" (R. 73), and, in successfully demonstrating its needs, it showed its "sales commitments," including its several long-term supply contracts, etc. (R. 76).

Taxpayer states in its brief: "Significantly at the time (July 1, 1941) when Petitioner had the largest amount of orders, its corn futures position was the smallest" (Br. 29). But as we have seen (*supra*, p. 37), taxpayer's witnesses explained that the liquidation of its long position in 1940 was due to the increases in price of competitive sugars which followed the outbreak of war abroad and the success of the 1939 crop. The reduction of its long position in response to these factors, then, contrary to taxpayer's intimations, illustrates the great extent to which the taxpayer in fact integrated futures purchases into its business operations to protect its manufacturing profits.

(iii) Taxpayer argues that since under its sales policy it "in actuality had no commitments for the sale of its products on which it could count," it had nothing to hedge (Br. 29). This would appear to be somewhat disingenuous. Taxpayer *on its part* was bound under its sale contracts, and it was for this reason that it found it in its business interest to hedge against increases in price. Naturally, customers who because of price advances found themselves with contracts to purchase corn products at prices below market prices would in the usual course of business take deliveries under those contracts. And in any event, in buying futures, the taxpayer must have relied on its experience as to cancellations. It may be noted that the Department of Agriculture found in another proceeding, as to 1952, that taxpayer on the

basis of past experience "forecasts what its sales will be for months ahead" with a small range of error. *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1125.[19]

(iv) We have already discussed taxpayer's argument that because of its sales policy it could protect itself only against increases in price and not against decreases in price (Br. 29–30) (see pp. 34–35, *supra*). The point is that taxpayer did protect itself against increases in price; under its method of doing business it could do no better. Taxpayer further argues that "price protection could have been obtained * * * only by sales of cane sugar futures" (Br. 29). But it is of no consequence to speculate as to what additional practices taxpayer might have resorted to in order more effectively to protect its business against market fluctuations; we are concerned only with what taxpayer did in fact do, and its relation to its manufacturing operations.

(b) Taxpayer's further contention (Br. 31) that it entered the market neither to hedge nor to speculate but as a "legitimate capitalist" is dealt with below.

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[19] We do not find record support for taxpayer's statement that "cancellations were frequent, unpredictable, and substantial" (Br. 29). It cites only one instance of a substantial cancellation (Br. 10; R. 69). But even if taxpayer's characterization is accurate, it is of no moment so long as it was able to forecast with some degree of accuracy its future sales.

2. Taxpayer did not deal in futures contracts as a speculator or independent "capitalist" separate and apart from its manufacturing business

Taxpayer is in a very difficult position in this proceeding. It cannot argue that it dealt in the futures market as a speculator, because that might increase its difficulties with the Department of Agriculture under the Commodity Exchange Act.[20] On the other hand, it cannot admit here that, as found by the courts below, it dealt in futures as a part of its corn-buying program and to stabilize inventory costs, because that would uphold the contention of the Government that the gains and losses on these transactions must, for tax purposes, be accounted for just like any other gains and losses in inventory operations. So it makes what amounts to an indirect attack on the findings of the courts below by suggesting that it dealt in futures during these years as a "legitimate capitalist" (Br. 21, 28, 30–31) and that these dealings were separate and apart from its manufacturing operations.

The label is unimportant. Even if descriptive of taxpayer's dealings in futures, which we doubt,[21]

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[20] See *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, appeal pending (C. A. 2d) *sub nom. Corn Products Refining Co.* v. *Benson.*

[21] In *United States* v. *Coffee Exchange*, 263 U. S. 611, 619, this Court divided those who deal in futures into three classes: (1) "those who use them to hedge"; (2) "legitimate capitalists who, exercising their judgment as to the conditions, purchase or sell for future delivery with a view to

the label would not serve to insulate these transactions from taxpayer's regular manufacturing operations, and give them a special, isolated status as capital assets. As we have seen, taxpayer purchased futures when it deemed the prices to be "advantageously low" (R. 204), took deliveries of very substantial amounts of corn under its futures contracts (R. 234–235), and sold others when it appeared certain that there would not be a poor crop (R. 24, 204). The fact that when it purchased any particular contract it did not know whether it would later sell the contract or take delivery under it would itself seem to distinguish taxpayer's operations from those of a speculator or independent "capitalist". Also, its officers emphatically testified that taxpayer did not speculate at any time (R. 43, 58, 60, 63), and that its purchases of futures were not in excess of its "needs" (R. 73, 76) "to protect the business from loss" (R. 63).

Taxpayer's present protestations, moreover, can hardly serve to detract from the force of the following findings of the Tax Court based on, among other things, testimony as to taxpayer's own representations to the Department of Agriculture in a pro-

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profit based on the law of supply and demand"; and (3) "gamblers or irresponsible speculators who buy or sell as upon the turn of a card." The second class would seem to fit informed speculators rather than manufacturers who, like taxpayer, purchase futures as a part of their inventory program and to protect themselves against increases in price.

ceeding which took place during the first taxable year (1940) involved in this suit (R. 204–205):

> During late 1939 and early 1940 petitioner maintained a long position in corn futures contracts of from 7,000,000 to 8,000,000 bushels. In 1940 the Commodity Exchange Authority formally charged petitioner with speculating in grain on the ground that it had a long position in excess by more than 2,000,000 bushels of the amount it required for hedging. At a hearing petitioner took the position that its futures were not in excess of its needs and that the contracts it held were necessary to cover the products which it expected to market over a period of 15 to 18 months. In demonstrating its needs petitioner submitted evidence as to its unfilled orders, its sales commitments, its contracts with the Huron Milling Company and the Keever Starch Company, and the estimated number of bushels of corn that would be required to meet such commitments. Petitioner relied also upon weekly and daily reports which it had filed with the Authority giving information as to its position with respect to grain futures. Petitioner had included in those reports, among other matters, detailed information as to its transactions in grain, and its purchase and sales commitments for grain, or grain products, and it stated in such reports that its futures were classifiable in character as hedging, rather than as speculative transactions. Petitioner was upheld in its con-

tentions in the proceeding before the Commodity Exchange Authority, and the action was dismissed.

See further R. 72–73, 76; *In re Corn Products Refining Co.*, 13 Agric. Dec. 1117, 1119, 1125, 1127–1128, 1132–1134.

The essential character of a manufacturer's hedging transactions, as we have seen, is that they are an integral part of its manufacturing operations. Taxpayer's present assertions that its futures dealings were for tax purposes separate and apart from its manufacturing operations must be considered in the light of the contrary assertions of record in the instant case, and further in the light of the fact that in 1940 it was able to convince the Department of Agriculture to the contrary with respect to some of the very transactions here in issue and with respect to a statutory provision under which a more technical concept of hedging is decisive.

The Tax Court found that "Petitioner's purchases of corn futures did not constitute speculative transactions for profit" (R. 206), and this was affirmed by the court of appeals (R. 297). In the circumstances, the conclusion of the two lower courts on this question, which is essentially factual, should not be disturbed. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214. Given these facts, we submit that the conclusion of the court below is inescapable (R. 297):

> The property here was used for essentially the same purpose and in the same manner as in true hedging. Futures contracts were entered into to stabilize inventory costs and thus protect profit, and whether complete or only partial insurance was thereby obtained is simply a difference in degree, not in kind. Therefore, for the same reasons that the true hedge is not accorded capital treatment under Section 117 (a), the kind of transactions with which we are now concerned are not to be regarded as capital ones either.'

II

CORN FUTURES CONTRACTS ARE NOT WITHIN THE SCOPE OF SECTION 118 OF THE INTERNAL REVENUE CODE OF 1939

Section 118 of the Code provides that no deduction shall be allowed to a corporation under Code Section 23 (f) for "any loss * * * from any sale * * * of shares of stock or securities" if within 30 days before or after the sale the taxpayer has acquired "substantially identical stock or securities." Both the Court of Appeals and the Tax Court rejected the taxpayer's contention that its transactions in corn futures were subject to the provisions of Section 118—a contention made contrary to the position it had taken in its tax returns.[22]

[22] For the base period years of 1938 and 1939 alone, the taxpayer, by invoking the application of Section 118, would now eliminate losses aggregating over $3,150,000. (See Col. 15, Ex. 1-A, R. 230.)

If the Court sustains our contention that taxpayer's hedging gains and losses do not qualify for capital gains treatment (Point I, *supra*), it need not reach this issue. Taxpayer's hedging profits could then be treated like any other profits derived from its manufacturing operations, and its losses would be deductible as ordinary and necessary business expenses under Section 23 (a) (1) (A). Or, with equal propriety, such profits and losses could be reflected as they were on taxpayer's tax returns for the period in question (R. 204), through adjustments in the cost of goods sold. If this view is accepted no question would remain for decision under Section 118, because that section has reference only to the deductibility of any "loss" otherwise deductible "under section 23 (f)." The latter section plainly has nothing to do with the deductibility of ordinary business expenses, which is otherwise provided for in Section 23 (a).

If, however, this Court should hold, in disagreement with the courts below, that taxpayer's futures transactions are to be treated as resulting in capital gains or losses, then, for the reasons stated under points A and B, *infra*, we maintain that the wash loss limitations of Section 118 do not apply.

A. FUTURES CONTRACTS ARE NOT "SUBSTANTIALLY IDENTICAL" ONE WITH ANOTHER

Section 118 was enacted to prevent a deduction for losses sustained in wash sales of securities;

that is, where the taxpayer at or about the time of a sale acquires identical or substantially identical securities. The deduction is postponed until the securities are disposed of and not replaced within thirty days. The purpose of the section was to prevent the taking of a "fictitious loss" in order to acquire a tax advantage, where the taxpayer did not truly alter his economic position. See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10, 11 (1939–1 Cum. Bull. (Part 2) 168, 176, 177); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 11–12, 14 (1939–1 Cum. Bull. (Part 2) 181, 189, 191); H. Conference Rep. No. 486, 67th Cong., 1st Sess., p. 24 (1939–1 Cum. Bull. (Part 2) 206, 214). The evil was deemed to be present only where the taxpayer sold and purchased "substantially identical" securities, for it was only in this circumstance that it could be said that a taxpayer had not changed his economic position.

Futures contracts, at least where they are of different maturities, do not meet this requirement (even if they be considered "securities"; but see pp. 52–58, *infra*). Inherently, a futures contract is nothing more than an agreement for the sale of a given quantity of a commodity to be delivered at a later date, and hence, there are obvious differences as to the identity of the sellers, the price and the delivery date. The most significant differences are, of course, in the time of delivery, since that is the cornerstone upon which the entire operation of the futures market is based. But for differences as to delivery dates, the futures com-

modity market as it is now operated on the various commodity exchanges would perform no useful function in our business and economic life. In the case of a manufacturer, the hedging process generally involves selling early maturities and buying later maturities, the volume of purchases varying with forward commitments. Indeed, trading in futures encompasses not only contracts for future delivery of the current year's crop but also contracts for future delivery of the crop which is yet to be harvested. Thus, in April of a given year a hedger may sell a contract calling for delivery of corn in May and purchase a contract calling for delivery of corn in December after another crop has been harvested. The two contracts are in no sense "substantially identical." Congress expressly recognized this when, in 1950 in another context, it provided in what became Code Section 117 (l) (3) (B) (ii), as added by Sec. 211, Revenue Act of 1950, c. 944, 64 Stat. 906, that "a commodity future requiring delivery in one calendar month shall not be considered as property substantially identical to another commodity future requiring delivery in a different calendar month * * *."

There is no merit to taxpayer's suggestion (Br. 48–49) that the "substantially identical" test is met because, even though there are different delivery dates, there is only a "small economic difference in the value of different maturities." This misrepresents the significance of price differentials in the

commodity markets, where trades frequently turn on changes in price of one-eighth of a cent. As shown in the table below,[23] moreover, price differentials between corn futures bearing different de-

[23] The daily current prices at Chicago for corn futures, on each of the dates indicated below, in 1942, show the following with respect to futures traded on that date for different delivery months (85th Annual Report of the Trade and Commerce of Chicago for 1942, by Chicago Board of Trade (Lincoln Printing Co., Chicago, 1943), pp. 56, 58, 60–62, 64, 66, 68, 70, 72, 74, 76, 78):

Date	Delivery Month	Delivery Month	Delivery Month	Delivery Month
Jan. 2	May: 84⅜-85⅜	July: 86⅛-87¼	September: 87½-88¾	
Feb. 2	May: 86¾-87⅝	July: 88⅜-89¼	September: 90-90⅞	
Mar. 2	March: 82⅝-83½	May: 86⅜-87	July: 88½-89	September: 90⅛-90⅞
Apr. 1	May: 88¼-88⅞	July: 90¾-91¼	September: 92¾-93⅜	
May 1	May: 83¼-85⅛	July: 86¼-88⅜	September: 88⅜-90⅜	
June 1	July: 86⅛-87⅛	September: 88¾-89⅝	December: 90⅞-92⅛	
July 1	July: 83½-87¼	September 88½-90	December: 91½-92¾	
Aug. 1	September: 87⅝-89	December: 90¼-91⅝	May: 94¼-95½	
Sept. 1	September: 83¼-84⅜	December: 86⅜-87½	May: 90-91	
Oct. 1	December: 85½-86¼	May: 90-90⅜	July: 91½-92	
Nov. 2	December: 79⅛-79⅞	May: 84½-85¼	July: 86¼-86⅞	
Dec. 1	December: 84½-85¼	May 89¾-90⅛	July: 91¼-92	

On occasion, the price of futures for different delivery months has varied even more sharply. For example, in August, 1937 the price for September delivery ranged from 90⅞ to 105⅞, and the price for December delivery ranged from 61¾ to 69⅞. See tables for Monthly Range of Prices, 85th Annual Report of the Trade and Commerce of Chicago for 1942, *supra*, p. 87.

livery dates were consistently substantial during the period in question.

Thus, in recognition of the fact that the purchase of a futures contract to replace one requiring earlier delivery is not a simple exchange of property "of a like kind" (see Code Section 112 (b) (1)), it has been held that sales of futures contracts are completed transactions when made, the gain or loss upon which is to be recognized at that time for tax purposes. *Valley Waste Mills* v. *Page*, 115 F. 2d 466 (C. A. 5th), certiorari denied, 312 U. S. 681; *Harriss* v. *Commissioner*, 143 F. 2d 279 (C. A. 2d), certiorari denied, 312 U. S. 681.

The conclusion of the courts below that the taxpayer was not engaged in "wash" sales of "substantially identical" contracts is confirmed by the fact that Section 4 (c) of the Commodity Exchange Act makes it unlawful to utilize trading in futures on a commodity exchange for the purpose of a "wash sale."[24] It should, of course, not be unnecessarily assumed that taxpayer en-

[24] Section 4c of the Commodity Exchange Act, c. 545, 49 Stat. 1491 (7 U. S. C., 1952 ed., Sec. 6c), provides that—

> It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity, which is or may be used for (1) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (2) determining the price basis of any such transaction in interstate commerce in such commodity, or (3) delivering any such commodity sold, shipped, or re-

gaged in illegal transactions. *Korbly* v. *Springfield Inst. for Savgs.*, 245 U. S. 330, 336. See, in this connection, *In re Jean Goldwurm*, 7 Agric. Dec. 265, in which proceeding violations of the Commodity Exchange Act were charged with respect to certain transactions in futures allegedly "of the character of 'wash sales'" (*id.* at 268). In that opinion, it was stated that the "essential and identifying characteristic of a 'wash sale' seems to be the intent not to make a genuine, bona fide trading transaction in stocks or commodities. A wash sale is a form of fictitious transaction" (*id.* at 274).

We conclude that futures contracts are not "substantially identical", one with another, and that for that reason they fall outside the scope of Section 118 of the Code.

B. FUTURES CONTRACTS ARE NOT "SECURITIES" WITHIN THE MEANING OF THE TERM AS USED IN SECTION 118

Taxpayer's transactions in corn futures fail to qualify under the wash-sales provisions of Section 118 for the additional, independent reason that futures contracts, as further held by the two lower courts, are not "securities" as that term is used in Section 118.

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ceived in interstate commerce for the fulfillment thereof—

(A) if such transaction is, is of the character of, or is commonly known to the trade as, a "wash sale", "cross trade", or "accommodation trade", or is a fictitious sale;

* * * * * *

The word "securities" normally refers to evidence of debt or property, such as stocks, bonds, notes, and the like. Significantly, all of the definitions of "securities" contained in the Internal Revenue Code of 1939, as amended, omit futures contracts from their scope. See Sections 22 (b) (9), 23 (g) (3), 23 (k) (3), 117 (n) (3), 165 (b), 373 (f), and 3672 (b) (2).[25] The word "securities" is similarly employed in the trade, and it is distinguished from commodities and contracts for the sale thereof.[26] The fact

[25] The definition in Section 3672 covers Government and corporate bonds, debentures, etc., negotiable instruments, and money. Taxpayer implies that this definition covers futures contracts (Br. 44). This is not so, for futures contracts are not negotiable instruments. They do not, for example, contain an unconditional promise or order to pay a sum certain in money. See Beutel's Brannan *Negotiable Instruments Law* (7th ed.), p. 209 *et seq.*

[26] See, *e. g.*, Rules and Regulations of the Board of Trade of Chicago, contained in 85th Annual Report of the Trade and Commerce of Chicago, for 1942, Chicago Board of Trade (Lincoln Printing Co., Chicago, 1943). The Rules contain separate definitions for the terms "Commodity" (p. 204) and "Security or Securities" (p. 206), as follows:

> "*Commodity.*—Any commodity which may be dealt in under Rules or Regulations of the Association."
>
> "*Security or Securities.*—Stocks, Bonds, Notes, Certificates of Deposit or Participation, Trust Receipts, Rights, Warrants, and other similar instruments."

Similarly, there are separate provisions fixing the rates of brokerage for the purchase and sale of "commodities" (pp. 250-257) and fixing commissions on the execution of orders for the purchase and sale of "securities" (pp. 257-260); rules fixing places "on the floor" of the exchange for making "any

that the word is used in its usual and normal sense in Section 118 is borne out by the legislative history of the section, a consideration of its purpose, and its context in the Internal Revenue Code.

As we have seen, Section 118 was introduced into the Code to prevent the taking of fictitious losses (and the gaining of a tax advantage) through the sale of securities and their repurchase within a short period of time under circumstances where the person concerned did not alter his economic position. As the reports accompanying the legislation make clear, the practice was one typically engaged in by investors selling stocks to establish losses and then immediately repurchasing the same securities. Indeed, throughout the reports, the words "securities" and "shares of stock" are used interchangeably.[27]

Significantly, these same reports are barren of any suggestion that this same practice was

transaction in securities" and for making "any transaction for future delivery of a commodity" (pp. 262-263), etc. Taxpayer purchased most of its corn futures contracts on the Chicago exchange (R. 88).

[27] See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 10, 11 (1939-1 Cum. Bull. (Part 2) 168, 176, 177); S. Rep. No. 275, 67th Cong., 1st Sess., pp. 11-12, 14 (1939-1 Cum. Bull. (Part 2) 181, 189, 191); H. Conf. Rep. No. 486, 67th Cong., 1st Sess., p. 24 (1939-1 Cum. Bull. (Part 2) 206, 214). Although the statutory language is "shares of stock or securities," the House and Senate reports refer only to "securities," and the Conference Report refers only to "shares of stock," thus indicating that the concern was with corporate securities.

deemed a problem requiring remedial legislation in the case of trading in commodity futures, although, of course, trading in futures was highly developed on the established commodity exchanges at the time. See, *e. g., Board of Trade* v. *Christie Grain & Stock Co.*, 198 U. S. 236; *United States* v. *Patten*, 226 U. S. 525. The reason for this must be, as noted by the Tax Court (R. 29), that commodity futures are "for such short periods and are of such a peculiar character that they do not lend themselves to the evil which section 118 was intended to prevent." Thus a person holding such futures could not build up an investment portfolio which he continues to carry over the years, while taking fictitious losses from time to time to offset gains which would otherwise be taxable. Because corn futures are of a maximum duration of 11 months, and because of the administrative cost of continually renewing holdings (see R. 55), there would be no tax saving incentive to the use of futures to establish fictitious losses.

On the other hand, if, contrary to our contentions, futures of different maturities should be considered substantially identical, Section 118 would have a different untoward result. If futures were considered securities within the meaning of Section 118, that Section would reach all processors who, in connection with their manufacturing operations, engage in hedging operations involving continual trading in futures.

The nature of hedging is such that the manufacturer who hedges generally works forward in the market, selling his contracts before they mature (or taking delivery) and purchasing new contracts to cover his new forward commitments. The effect of holding Section 118 applicable to futures would be to require losses, whenever a sale is followed or preceded by a purchase within 30 days, to be carried forward from year to year without being accorded tax recognition. This would not only be contrary to the fundamental pattern of the taxing statute which requires an annual accounting of business profits and losses, but would place the processor who assumes the risk of price changes in a different position from the one who transfers part or all of that risk to others by dealing in futures. It should not be lightly assumed, without warrant in the legislative history or in the text of the statute, that Congress intended this result.

Our conclusion that "securities" is used in Section 118 in its usual and normal sense is buttressed when other provisions of the Internal Revenue Code are considered. We have noted above that all definitions of the word "securities" contained in the Code exclude futures contracts from their scope. On the other hand, wherever Congress intended that a provision of the Code should cover both securities and commodity futures, it specifically so provided. See Section 332 (b), (c); Section 502 (b), (c); Section 117 (l) (3)

(B) (i) (added to the 1939 Code by Sec. 211 of the Internal Revenue Act of 1950, c. 994, 64 Stat. 906). Cf. Section 1233, Internal Revenue Code of 1954. The conclusion is inescapable that Congress has not used "securities" in Section 118 in the broad and unusual sense suggested by taxpayer.

Taxpayer relies on the contrary conclusion of the Court of Appeals for the Sixth Circuit in *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, rehearing denied, 148 F. 2d 208 (Br. 45–48). But the court in that case made no reference to the legislative history of Section 118, to the definitions of "securities" contained in the Internal Revenue Code, or to the fact that Congress has invariably expressly referred to commodity futures when it intended to include them within the scope of a provision otherwise applicable to securities. That court based its decision rather on the notion that futures contracts were securities because they were pledged to the broker "who had advanced the necessary funds to purchase the oil" (147 F. 2d at 37), and because the owner "had no more than a document giving it the right to demand and receive property not in its possession" (*ibid.*). But, as the Tax Court pointed out (R. 28), any pledged property is a security in the former sense[28] and any executory contract giving a person the right

[28] The Tax Court added (R. 28): "Furthermore, the reasoning is unsound since the broker does not advance the funds necessary to purchase the commodity."

to demand and receive property upon the payment of a contract price is a security in the latter sense. Patently, pledged property in general and all executory contracts are not to be regarded as securities within the meaning of Section 118. The courts below correctly rejected the reasoning of the court in the *Trenton Cotton Oil* case. Futures contracts are not "securities" within the intendment of Section 118.

CONCLUSION

For the foregoing reasons, the decision of the Court of Appeals is correct, and should be affirmed.

Respectfully submitted,

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APPENDIX

INTERNAL REVENUE CODE OF 1939

CHAPTER 1—INCOME TAX

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(26 U. S. C. 1952 ed., Sec. 112.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject

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to the allowance for depreciation provided in section 23 (l) * * *;[54]

* * * * * *

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *[55]

* * * * * *

(26 U. S. C. 1952 ed., Sec. 117.)

SEC. 118. LOSS FROM WASH SALES OF STOCK OR SECURITIES.

(a) In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange upon which the

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[54] Section 117 (a) (1) was amended, in respects not here material, by Section 115 (b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and by Section 151 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, which added provisions excluding Government obligations issued on a discount basis and real property used in trade or business, respectively.

[55] As applicable to the year 1942, after amendments by Section 212 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 150 (c) of the Revenue Act of 1942, *supra*, this provision was as follows:

(d) *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction for the loss shall be allowed under section 23 (e) (2); nor shall such deduction be allowed under section 23 (f) unless the claim is made by a corporation, a dealer in stocks or securities, and with respect to a transaction made in the ordinary course of its business.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 118.)

CHAPTER 2—ADDITIONAL INCOME TAXES

* * * * * *

SUBCHAPTER E—EXCESS PROFITS TAX

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"].

SEC. 710. IMPOSITION OF TAX.

(a) [as amended by Section 201 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 202 of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Imposition.*—

(1) *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

* * * * * *

(b) [as amended by Section 2 (a) of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17, and by Sections 204 (a) and 205 (g) (1) of the Revenue Act of 1942, *supra*] *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in Section 711) minus the sum of:

(1) *Specific exemption.*—A specific exemption of $5,000 * * *;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) *Unused excess profits credit.*—The amount of the unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

* * * * *

(26 U. S. C., 1952 ed., Sec. 710.)

SEC. 711. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

* * * * *

(B) [as amended by Section 207 (a) of the Revenue Act of 1942, *supra*] *Gains*

and Losses From Sales or Exchanges of Capital Assets.—There shall be excluded gains and losses from sales or exchanges of capital assets held for more than 6 months.

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(26 U. S. C. 1952 ed., Sec. 711.)

SEC. 712 [as amended by Section 13 of the Excess Profits Tax Amendments of 1941, *supra*]. EXCESS PROFITS CREDIT—ALLOWANCE.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. * * *

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(26 U. S. C. 1952 ed., Sec. 712.)

SEC. 713 [as amended by Section 4 (b) of the Excess Profits Tax Amendments of 1941, *supra*, and Sections 215 and 228 (e) (2) of the Revenue Act of 1942, *supra*]. EXCESS PROFITS CREDIT—BASED ON INCOME.

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section shall be—

(1) *Domestic corporations.*—In the case of a domestic corporation—

(A) 95 per centum of the average base period net income, * * *

* * * * * *

(b) *Base Period.*—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; * * *

* * * * *

(d) *Average Base Period Net Income—Determination.*—

(1) *Definition.*—For the purposes of this section the average base period net income of the taxpayer shall be the amount determined under subsection (e), subject to the exception that if the aggregate excess profits net income for the last half of its base period, reduced by the aggregate of the deficits in excess profits net income for such half, is greater than such aggregate so reduced for the first half, then the average base period net income shall be the amount determined under subsection (f), if greater than the amount determined under subsection (e).

* * * * *

(e) *Average Base Period Net Income—General Average.*— The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. * * * ;

(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

(3) By multiplying the amount ascertained under paragraph (2) by twelve.

(f) *Average Base Period Net Income—Increased Earnings in Last Half of Base Period.*— The average base period net income determined under this subsection shall be determined as follows:

(1) By computing, for each of the taxable years of the taxpayer in its base period, the excess profits net income for such year, or the deficit in excess profits net income for such year;

(2) By computing for each half of the base period the aggregate of the excess profits net income for each of the taxable years in such half reduced, if for one or more of such years there was a deficit in excess profits net income, by the sum of such deficits. For the purposes of such computation, if any taxable year is partly within each half of the base period there shall be allocated to the first

half an amount of the excess profits net income or deficit in excess profits net income, as the case may be, for such taxable year, which bears the same ratio thereto as the number of months falling within such half bears to the entire number of months in such taxable year; and the remainder shall be allocated to the second half;

(3) If the amount ascertained under paragraph (2) for the second half is greater than the amount ascertained for the first half, by dividing the difference by two;

(4) By adding the amount ascertained under paragraph (3) to the amount ascertained under paragraph (2) for the second half of the base period;

(5) By dividing the amount found under paragraph (4) by the number of months in the second half of the base period and by multiplying the result by twelve;

(6) The amount ascertained under paragraph (5) shall be the average base period net income determined under this subsection, except that the average base period net income determined under this subsection shall in no case be greater than the highest excess profits net income for any taxable year in the base period. * * *

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(26 U. S. C. 1952 ed., Sec. 713.)

SEC. 728. MEANING OF TERMS USED.

The terms used in this subchapter shall have the same meaning as when used in Chapter 1.

(26 U. S. C. 1952 ed., Sec. 728.)

SEC. 729. LAWS APPLICABLE.

(a) *General Rule.*—All provisions of law (including penalties) applicable in respect to the taxes imposed by Chapter 1, shall, insofar as not inconsistent with this subchapter, be applicable in respect of the tax imposed by this subchapter.

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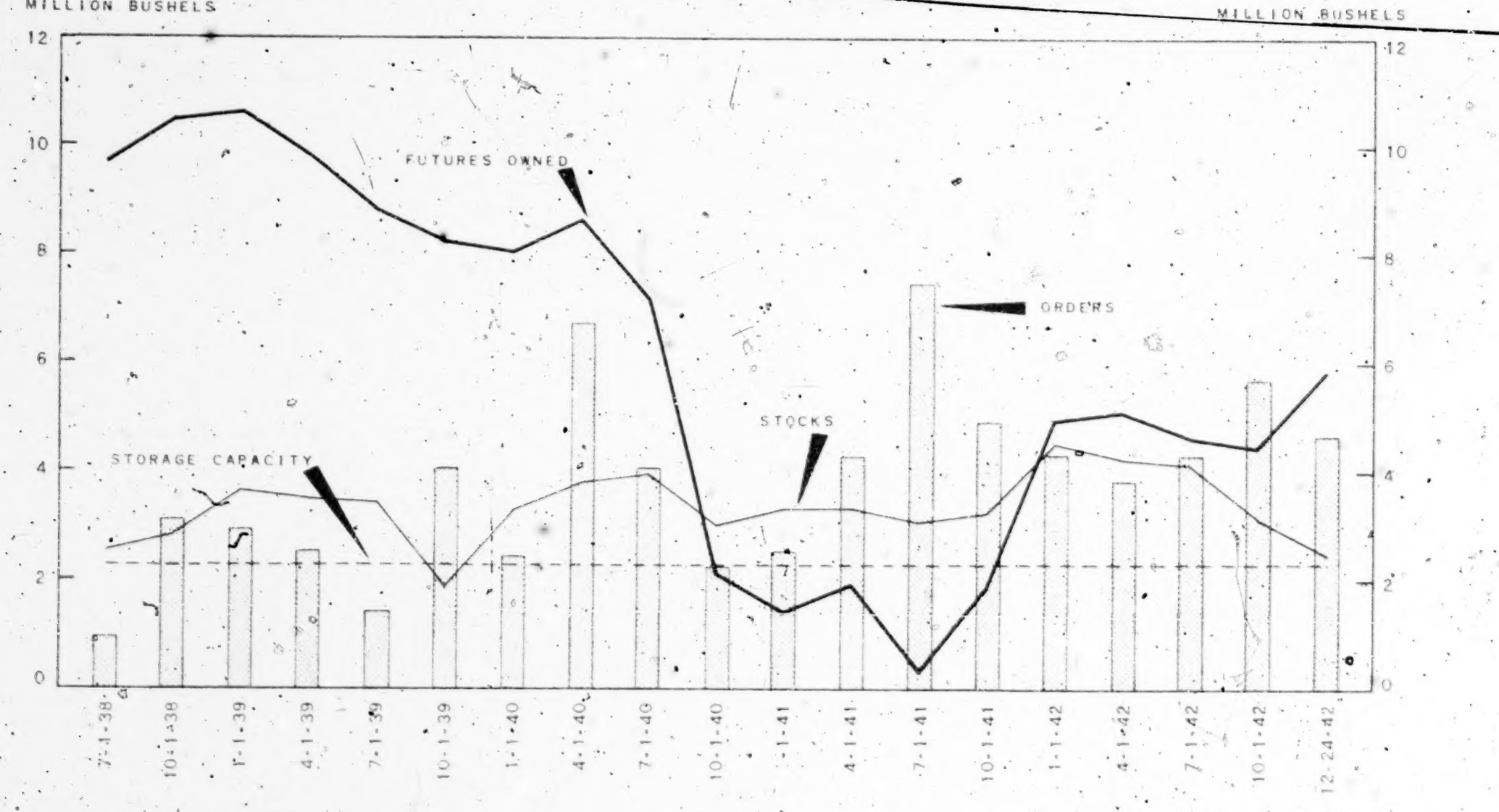
(26 U. S. C. 1952 ed., Sec. 729.)

U. S. GOVERNMENT PRINTING OFFICE 1955

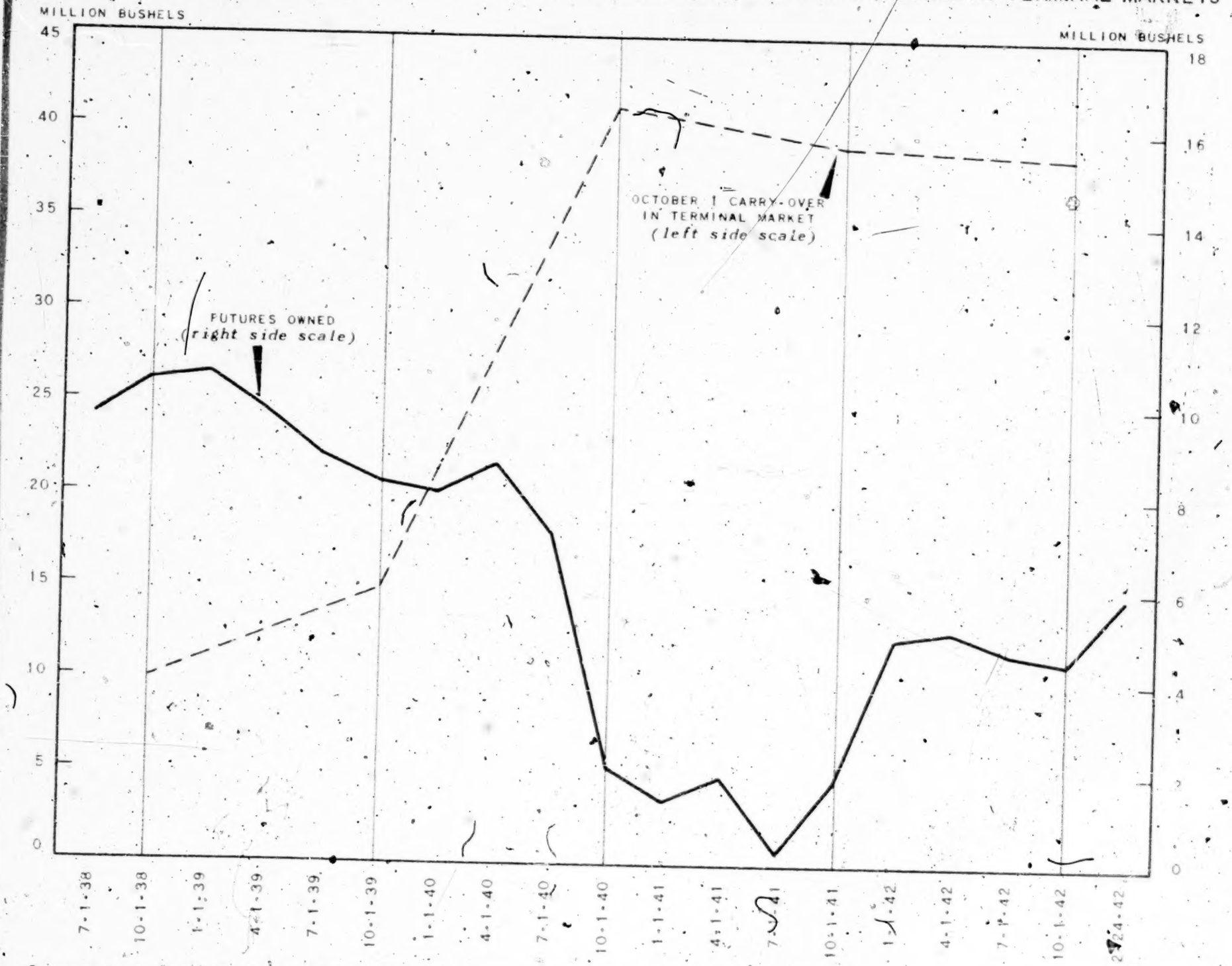
Commissioner's Chart No. 1

Corn Products Refining Company: ORDERS, STORAGE CAPACITY, STOCKS, AND FUTURES OWNED



Commissioner's Chart No. 2

Corn Products Refining Company: FUTURES OWNED AND COMMERCIAL CORN CARRY-OVERS AT TERMINAL MARKETS



Source: Agricultural Statistics, 1945, United States Department of Agriculture, p. 45, Table 51.